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C O N F I D E N T I A L SECTION 01 OF 03 HARARE 000740

SIPDIS

AF/S FOR B. NEULING
EB/IFD/OMA FOR F. CHISHOLM
NSC FOR SENIOR AFRICA DIRECTOR C. COURVILLE

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TAGS: ECON EFIN PGOV SOCI PHUM EINV ZI
SUBJECT: ECONOMIC POLICY STATEMENT OFFERS LITTLE HOPE

REF: HARARE 737

Classified By: Ambassador Christopher W. Dell under Section 1.4 b/d

¶1. (C) SUMMARY: Reserve Bank Governor Gideon Gono's Monetary Policy Statement of May 19 set out a series of piecemeal prescriptions that most local economists and business people agree will be unable to stem Zimbabwe's continued economic decline, including soaring inflation, a deteriorating currency, and moribund exports. The statement confirms that the GOZ,s economic policies will rely increasingly on state intervention rather than liberalization that could offer hope for the private sector. Zimbabwe's ongoing economic decline has accelerated since Gono's announcement. END SUMMARY.

Gono,s Speech

¶2. (U) The new policies/recommendations Gono announced May 19 included:

-- An upwardly revised "diaspora exchange rate" to 9000:1 (about 1/3 of the current parallel rate); no change to the controlled auction system for local enterprises.

-- upward revision in interest rates to 160 percent for secured lending and 170 percent for unsecured lending (slightly above the officially published rate of inflation).

-- establishment of Z$5 trillion (US$800 million at the current auction rate) Agricultural Sector Productive Enhancement Facility available at 20 percent interest rates.

-- establishment of Z$100 billion (US$16 million) export market fund available for exporters at 5 percent interest rates ("exporter" not defined).

-- subsidies for cotton and tobacco industries.

-- boosting of export incentive bonuses.

-- statutory reserves for building societies hiked to 35 percent.

-- barring of "non-essential" imports from Zimbabwe ("non-essential" undefined).

-- tightening of regulation of numerous sectors, including banks, finance companies, real estate agents, and building societies.

-- tighter controls on operation of foreign currency accounts.

-- heavy enforcement efforts against all violators.

Tougher Enforcement

¶3. (C) In his 2 -hour nationally televised address, Gono lashed out at the greedy "economic saboteurs" and indisciplined elements on whom Gono vowed the GOZ would clamp down. He urged that new jails be built in rural areas to house them and that they be put to work on farms that were suffering from a labor shortages. He was no less truculent in his briefing to foreign diplomats, citing with approval the Chinese execution of a CEO of a major conglomerate in the early 1990s. Employers' Confederation of Zimbabwe (ECZ) Chairman John Mufukare told econoff on May 23 that the economy would come to a complete halt if the GOZ followed through on its promises of strict enforcement. However, Mufukare predicted that the GOZ would relax restrictions after a couple of weeks of flexing its muscle (see reftel on government crackdown against the informal economy).

Forex Crisis to Continue

¶4. (SBU) Perhaps most disappointing to the private sector has been Gono's failure to address the forex crunch. By not

changing the totally inadequate forex auction, which has been satisfying less than one percent of bids, the GOZ assures that ballooning local demand for forex will continue to be unmet, further suffocating an economy gasping for imported inputs. Asked during a diplomatic briefing on May 20 how companies who needed forex but could not access it through the auction (describing virtually all formal economy players here), Gono could only offer "by all means other than illegal means."

¶5. (SBU) In the week since Gono's announcement, the parallel rate has risen from 20-22,000:1 to about 24-25,000:1, and the "blend rate" (rate used by companies for inter-company transactions) has risen from 13,000:1 to 16,000:1. Thus, the 45 percent devaluation in the diaspora exchange rate has done nothing to arrest the Zimdollar's slide on the market. Moreover, local economists predict its slide will accelerate now that the GOZ has made clear it will offer no relief.

Hyper-Inflation to Continue

¶6. (SBU) The GOZ's promises of subsidies and below-market credit will far outstrip its capacity and continue to the fuel the inflation rate. Local economist John Robertson related to econoff on May 24 that cotton subsidies alone would cost an estimated Z$525-700 billion (US$85-110 million). Subsidies to support last year's volume of tobacco sales would amount to Z$1.9 trillion (US$305 million). By way of perspective, the total currency in circulation in Zimbabwe in 2004 was Z$1.9 trillion. Asked at his diplomatic briefing how the GOZ would fund such generosity, Gono could only suggest it would shift money from inefficient parastatals. A more likely answer is continued acceleration of the money supply, which has been growing by over 200 percent in recent months.

Lending to Dry Up

¶7. (C) Local Finhold Bank economist Best Doroh on May 24 told econoff that the margins available to banks under the new rates and regime would not support much lending, especially in the areas targeted by the government. Even before the policy statement, banks were limiting lending largely to consumer loans, which he predicted would soon dry up as well. Mufukare stressed that easy local money did nothing to help local productivity since foreign suppliers would not accept it and it only fueled inflation; what producers needed first and foremost was access to foreign currency.

Economic Activity Likely to Shrink Further

¶8. (C) Gono's measures have deflated expectations throughout the private sector. Dulux Paints, for example, confides that it will cease domestic operations if it cannot access forex with which to import needed inputs. Colgate-Palmolive reports that it is now limiting operations to maintenance activities; production has stopped, principally due to a lack of diesel fuel that the new policies did nothing to address. Coca Cola told us that it was imposing compulsory leave of three months for selected staff.

Comment

¶9. (C) Gono's announcement must have been personally humiliating and signals his eclipse as a putatively meaningful player in the Mugabe regime. For months, he had been promising private sector players and diplomats that he would be able to deliver a meaningful devaluation and effective curbs on inflation after the parliamentary elections. Local press had reported in the weeks preceding the address that Gono had tried unsuccessfully to resign, foreshadowing that his recommendations were finding little purchase with Mugabe. His final offering delivered nothing to an economy that can be expected to deteriorate further. It underscores the primacy of politics - i.e. Mugabe's own ideology and assessment of personal self-interest - over national economic interest. With no GOZ or ZANU-PF advocates for economic reform willing to stand up to Mugabe, we see no prospect for meaningful economic reform in the foreseeable future.

¶10. (C) Since Gono's policy statement the regime has reverted to its typical authoritarian practices, using the police to enforce its crackdown on the informal sector (reftel). Over the past weeks hundreds of small businesses have been burned down or toppled, "illegal" housing (often built initially with GOZ encouragement) is being bulldozed,

and as many as ten thousand informal sector merchants have been detained (according to the state media). Fuel cannot be found anywhere in Harare, public transport has ground to a halt and staples such as corn meal, sugar and milk have disappeared from stores. The assault on the informal sector markets - a traditional "survival mechanism" for the urban population seems illogical but many Zimbabweans believe Mugabe is deliberately trying to provoke confrontation in order to crush any and all opposition to his regime.
DELL